

# **Seattle City Light Financial Baseline Discussion**

**Presentation to  
Energy Technology & Civil Rights Committee**

**February 2, 2011**



# Overview of Financial Baseline

- Prepared as a part of strategic planning effort
- Describes a baseline cost projection for maintaining City Light operations in generally the current configuration for 2011-2016.
- “Reference case” for use in the upcoming phase of the strategic planning process where various initiatives are considered and an overall strategy is proposed.
- Key finding: to maintain current level of service, rate increases averaging about 4.2% per year will be required for years 2012-2016.

# Topics Addressed in Financial Baseline

1. Industry Context, Cost Drivers and Uncertainty
2. Financial Forecast Assumptions
3. Key O&M Assumptions (by Expense Type)
4. Baseline Rate Projection and Conclusions

# 1. Industry Context, Cost Drivers, Uncertainty

- **Current industry concerns (due to cost/rate increases required)**

- Reliability, Smart Grid, cyber security
- New environmental regulations/  
green power investments
- Energy price volatility
- Uncertain demand
- Aging workforce

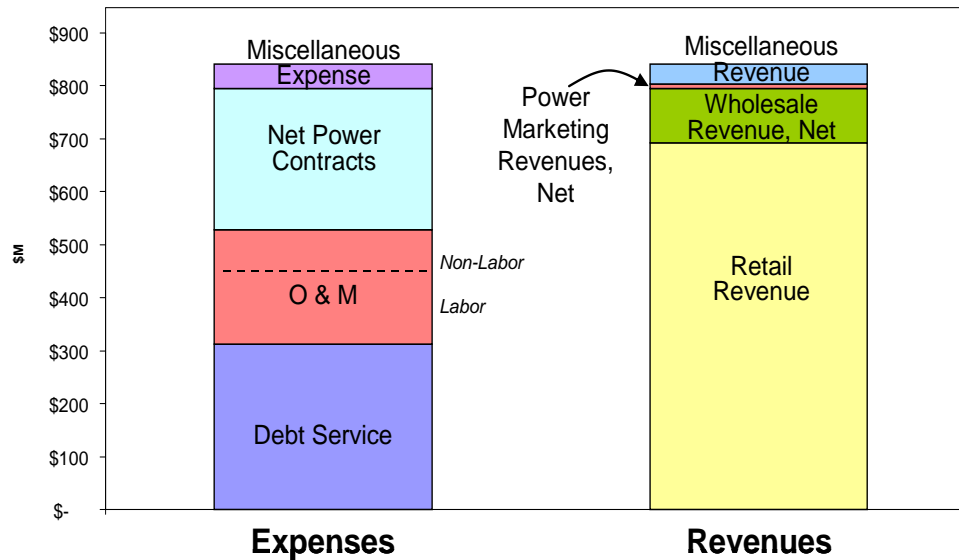
*Issues for  
City Light Also*

- **Cost trends over last decade**

- Production
- Transmission
- Distribution
- Administrative and General

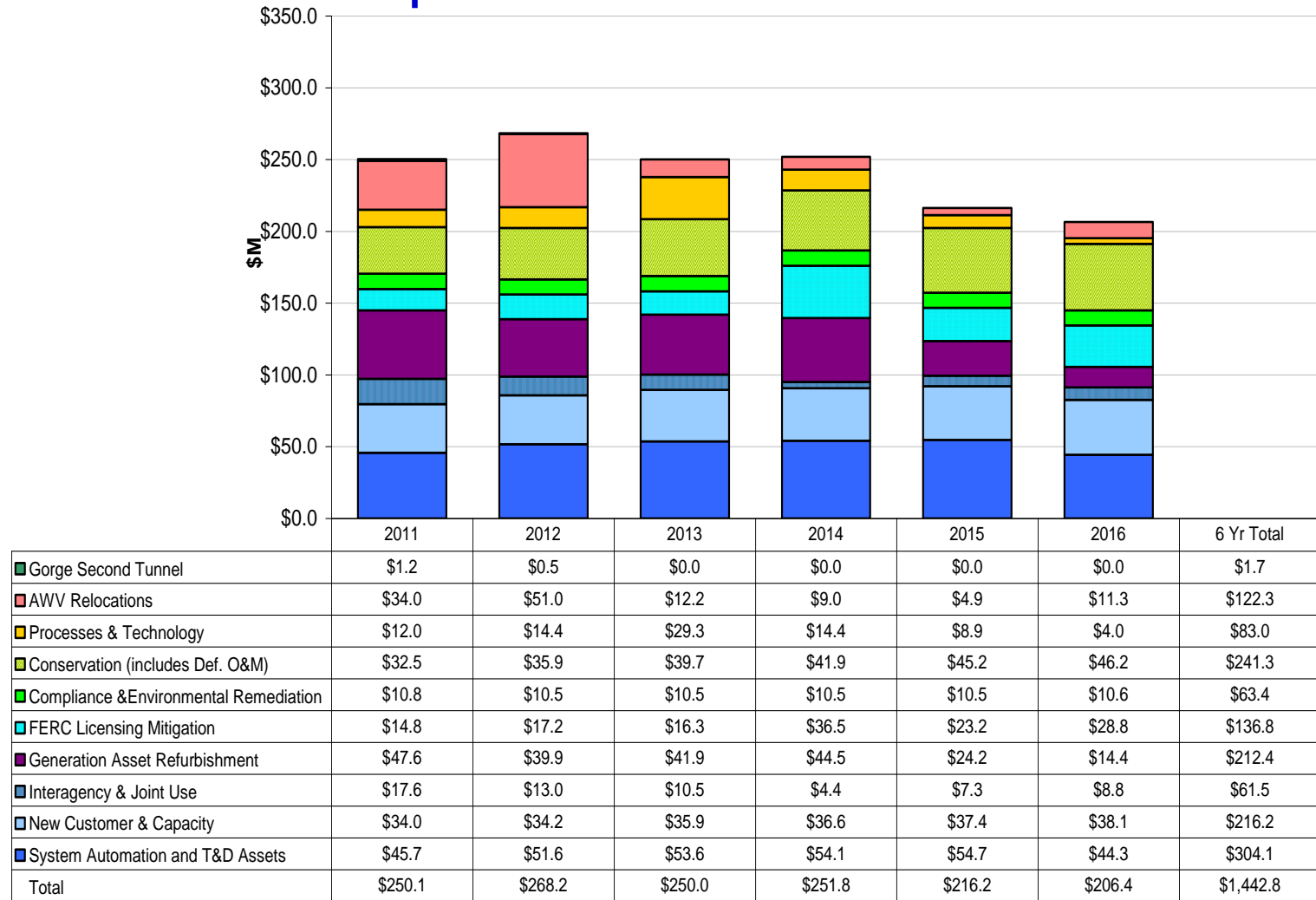
*City Light Cost  
Trends Comparable  
to Industry in these Areas*

## 2. Financial Forecast Assumptions



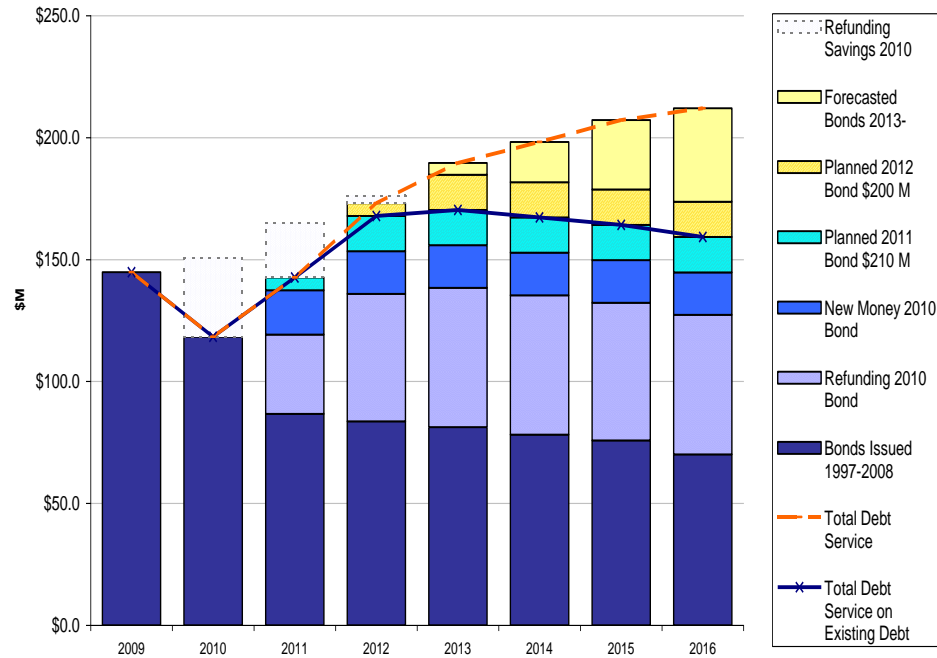
- Major determinants of rates are debt service and coverage, power costs, O&M costs and net wholesale revenue.
- O&M Labor & Benefits costs are only about 15% of total revenue requirement.
- Most expense items are relatively/entirely fixed, while net wholesale revenue is highly variable (mitigated by RSA).

## 2.1 Capital and Deferred O&M



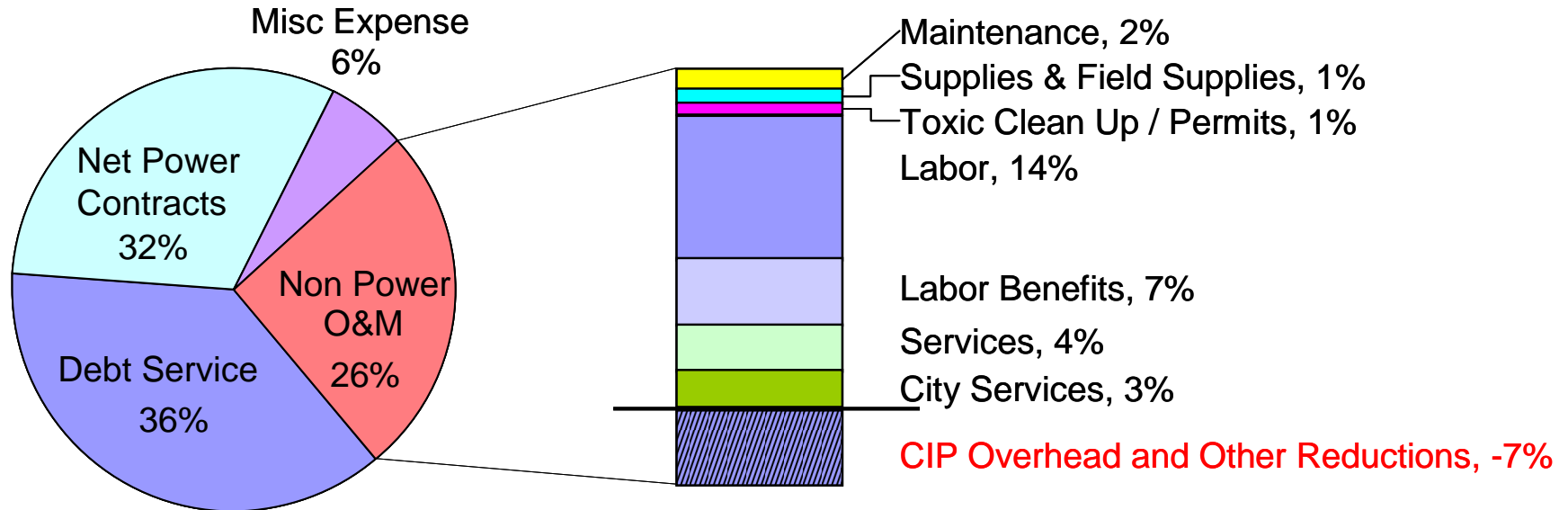
- Adjusted Baseline (-\$165M) excludes some high \$ projects such as Advanced Metering Infrastructure, North Downtown Substation/Network, transmission congestion mitigation, Gorge 2<sup>nd</sup> tunnel

## 2.2 Debt Service



- Debt service is rising due to low wholesale revenue in 2009-2010, change of coverage from 2.0 to 1.8x, 2010 bond refinancing savings that masked 2010-2011 increase (but saved ratepayers \$57M).
- Debt to capitalization ratio is still decreasing.

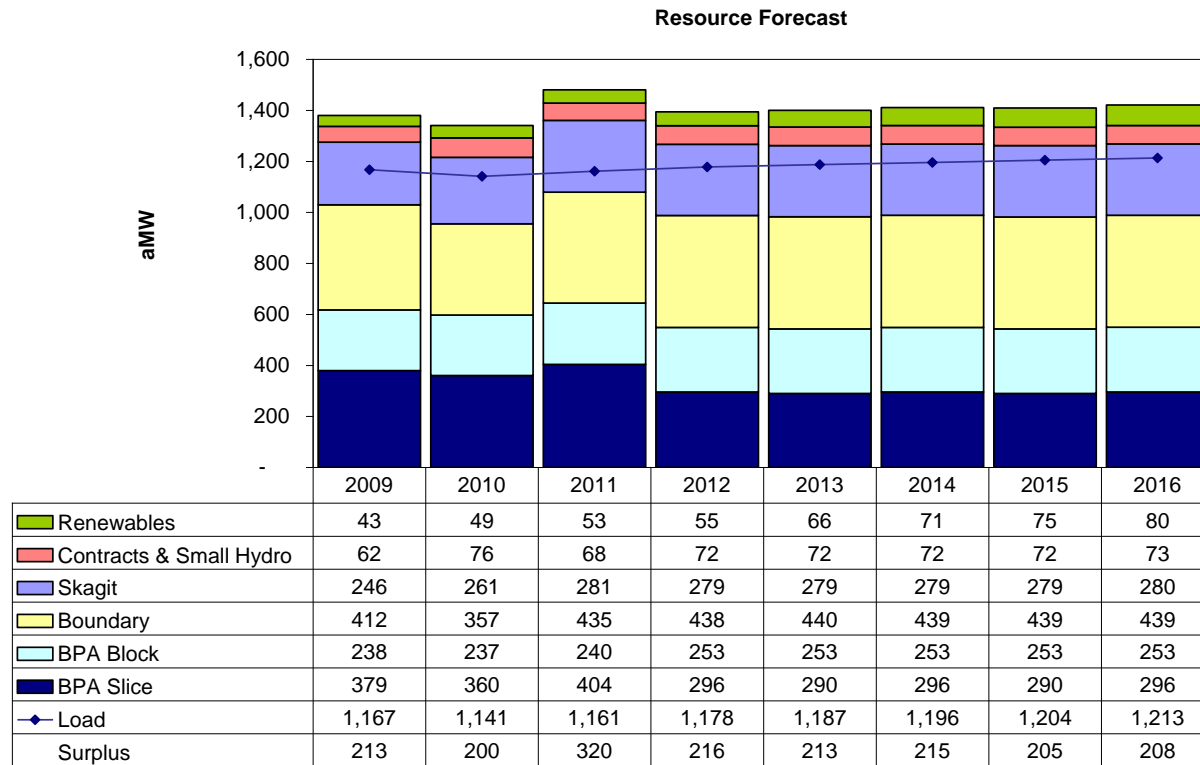
## 2.3 Non-Power O&M Costs



- Growth: 2002-2009 6%/year, 2011-2016 4%/year
- Inflators discussed in Section 3 (e.g., CPI or other %)

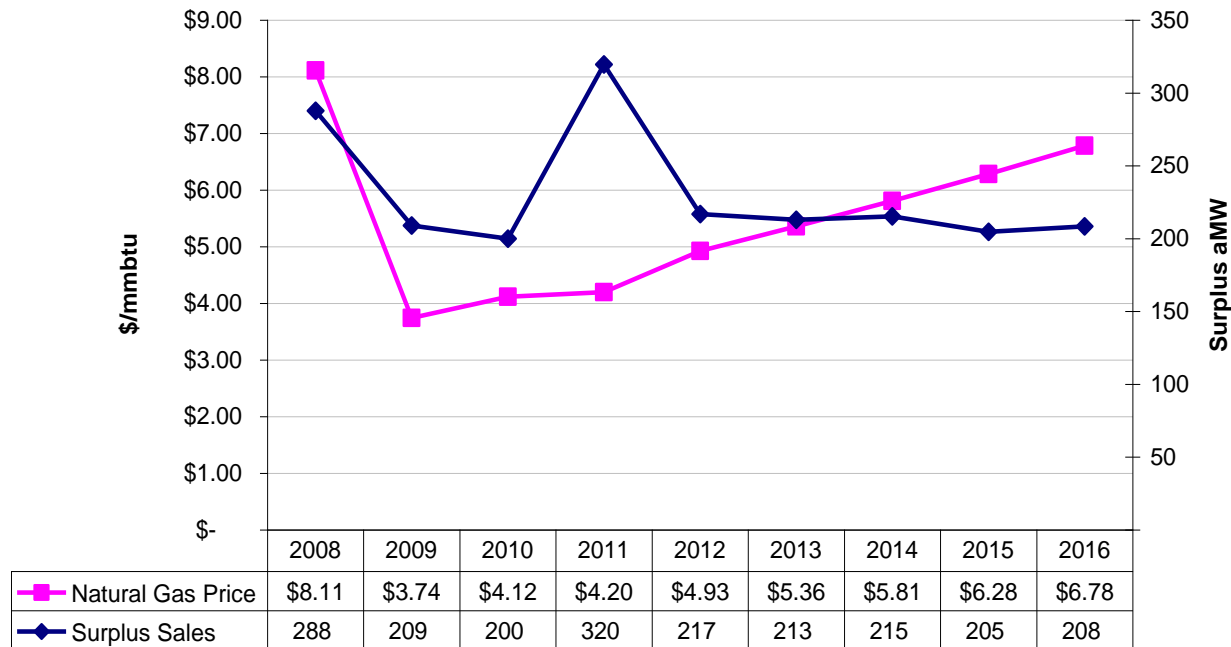


## 2.4 Power Contract Costs & Revenues



- Less power from new BPA contract commencing Oct. 2011
- BPA rates change every 2 years; pass-through to customers
- Planned renewables costs uncertain

## 2.5 Net Wholesale Energy Revenue (NWR)

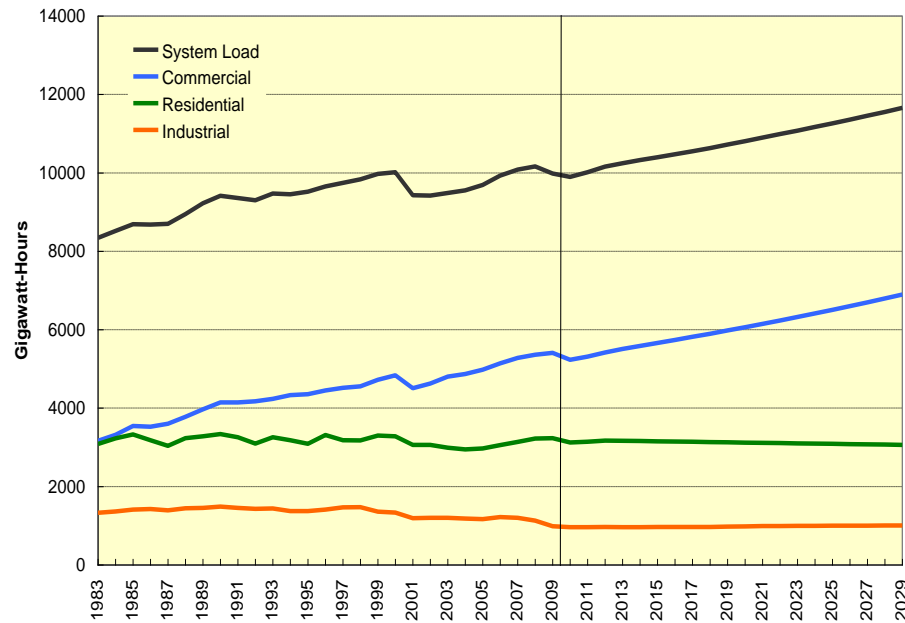


- Actual Revenue driven by unpredictable precipitation/streamflows and wholesale energy prices.
- NWR forecast for rates set by RSA ordinance (> current SCL forecast).
- RSA helps address volatility, but setting NWR too high may lead to ongoing surcharges.

## 2.6/2.7/2.8: Other Revenues & Expense

- Net Power Marketing Revenues
  - Optimizing SCL's power/transmission portfolio.
  - Falls starting 2012 due to changes in BPA contract, increasing retail load, lower REC revenues.
- Miscellaneous Revenue
  - Property sales, investment income, suburban undergrounding payments, operating fees and grants, distribution capacity charges, retail green power programs, power factor charges.
  - Property sales revenue could increase and reduce rates if lengthy City process changed.
- Rate discounts, Uncollectibles, Taxes, Franchise Payments
  - First 3 = % of revenues
  - Franchise payments based on long-term agreements

## 2.9 Retail Revenue (from Rates)

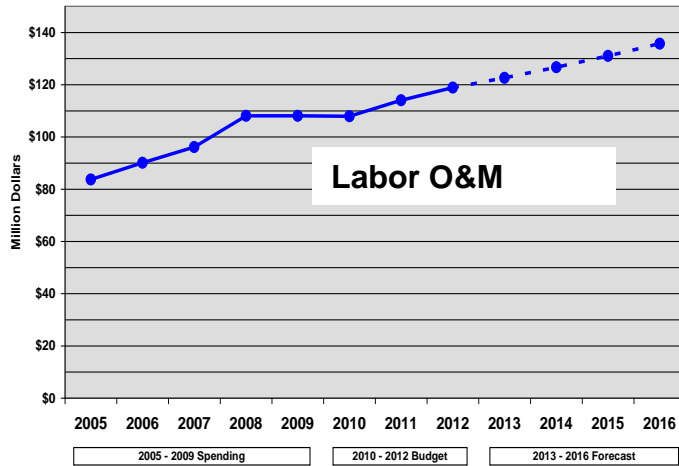


- 80% (+\$700M) of total revenue to run SCL's daily operations
- 2011-2012 revenue: \$ = Adopted rates \* demand
- Future revenue: rates to be set to cover total cost of operations less non-retail revenues
- Retail load forecast by customer rate class, growing <1% per year overall. Growth anticipated only in Commercial class.

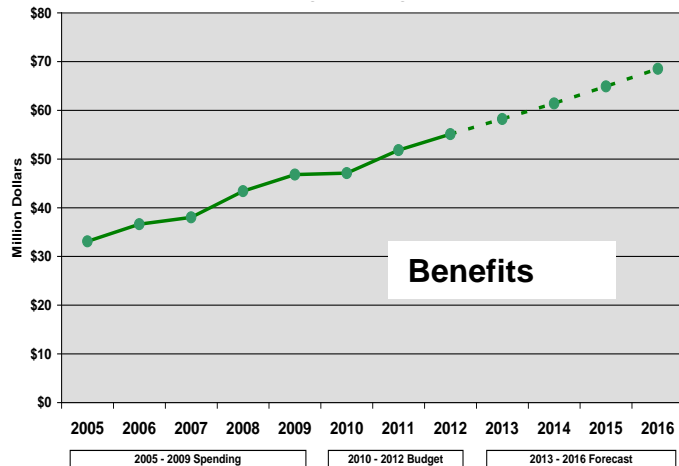
### 3. Key O&M Assumptions (by Expense Type)

	<b>Growth</b>	<b>% total expenditures</b>
Labor	CPI + 1%	14%
Labor benefits	7%	7%
Misc. benefits (e.g., overtime meals)	CPI	
City Services	CPI	4%
Outside services		3%
Maintenance	CPI + 1%	2%
Data processing maintenance	3%	
General supplies and materials	CPI	<1%
Field supplies	8%	
Toxic cleanup	Direct forecast	<1%
Permits (e.g., FERC fees)	5%	
CIP Overhead and Other Reductions		-7%
Total O&M		26%

# 3.1 Labor and benefits

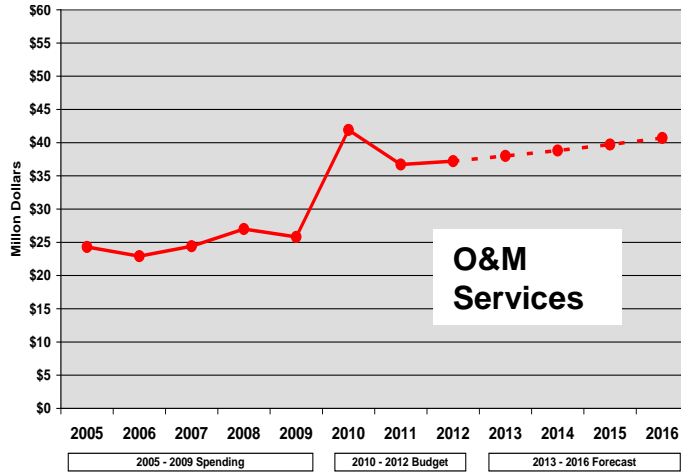


- ~14% of total expenses
- Increasing at inflation + 1% based on 2000-2008 wage rate growth
- Headcount peak = 2077 in 1992, 2011 on = 1824, 4% vacancy

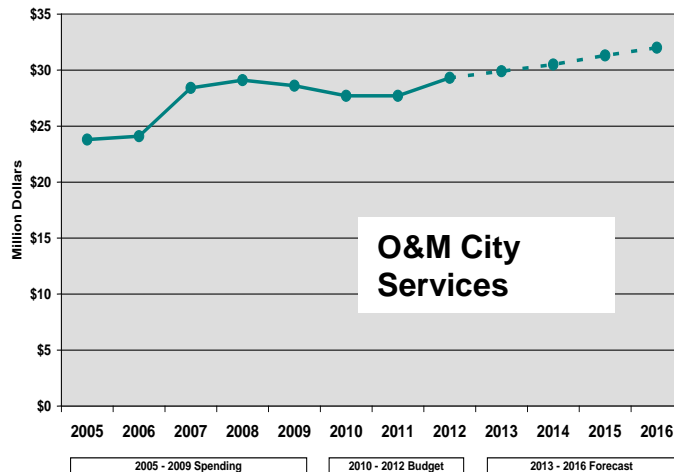


- ~6% of total expenses
- Special clothing/meals - CPI
- High growth in medical-dental-vision insurance, pensions: 7% based on 2011-2012

## 3.2/3.3 Services (outside & City)



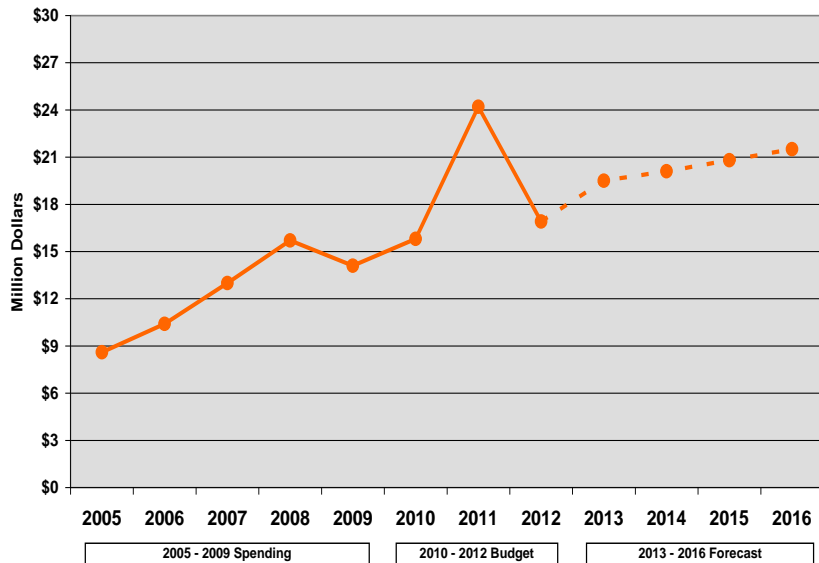
- ~4% of total expenses
- Increasing at inflation
- Engineering, architectural, DP & professional contracts, training & travel



- ~3% of total expenses
- Increasing at inflation
- Space rent, SPU call center, DoIT costs, City cost allocations

## 3.4 Maintenance

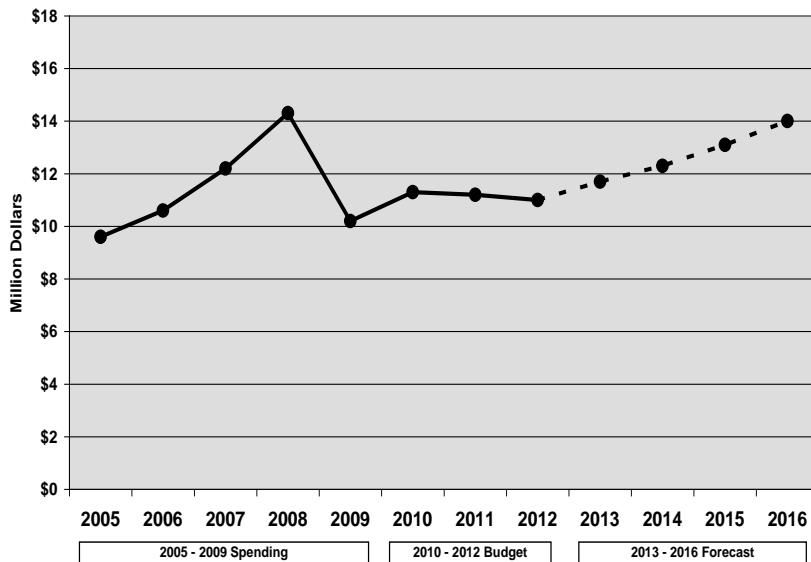
- ~2% of total expenses
- General maintenance growth at CPI + 1% based on contracted labor costs
- IT maintenance growth at 3% based on historical rate
- Payments to outside vendors for tree trimming and maintenance of facilities, IT equipment, and distribution system.





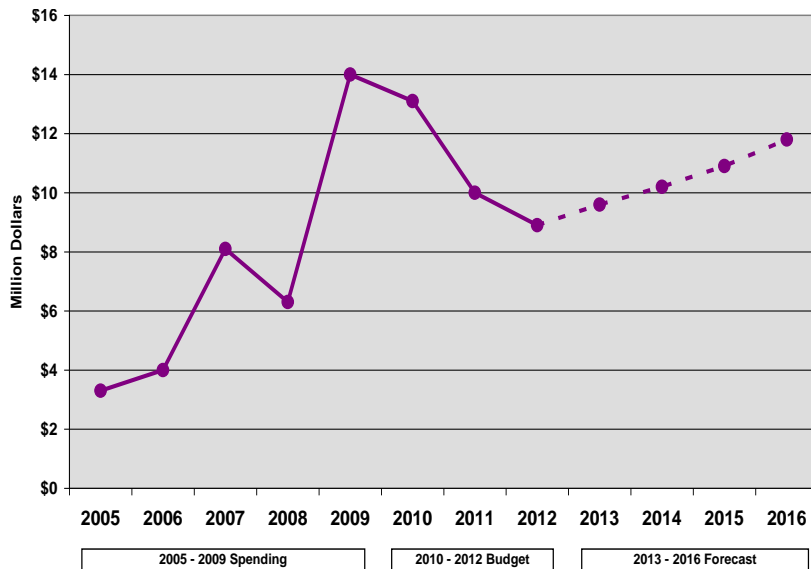
## 3.5 Supplies and Materials

- ~1% of total expenses
- General supplies & materials growth at inflation
- Field supplies & materials growth at 8% based on cost of copper and steel
- IT equipment and software, fuel costs, and materials for generation and distribution systems



## 3.6 Permits, Injury and Environmental Claims

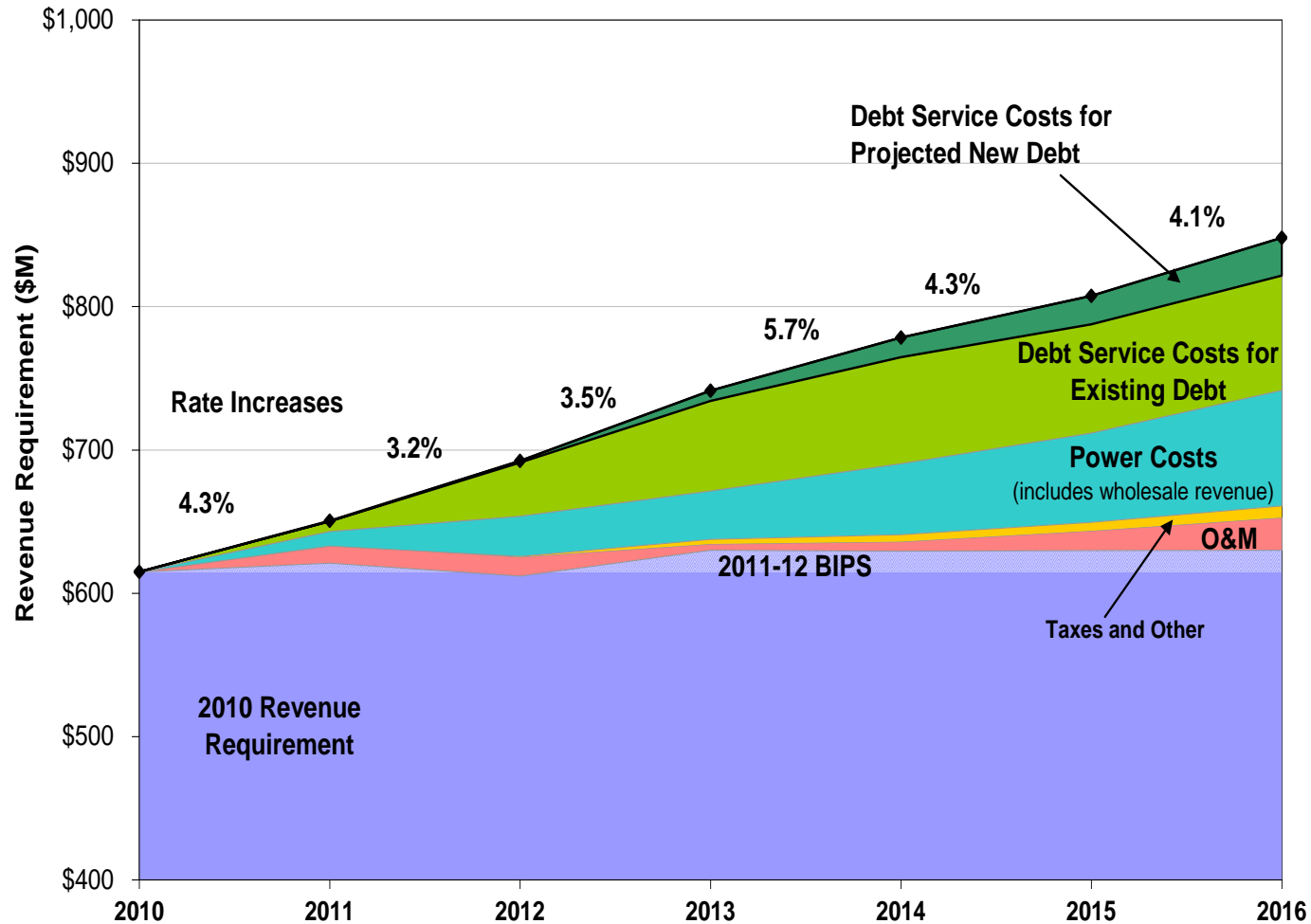
- ~1% of total expenses
- Permit growth (e.g., FERC fees) at 5%
- Injury claims included in labor benefits
- Environmental cleanup growth based on cost of work completed and known obligations.



## 3.7 CIP Overhead and Other Reductions to Forecast Non-Power O&M Costs

- -7% of total expenses
- Deductions of labor, benefits, supplies and materials costs due to assignment to CIP/Deferred O&M
- Deductions for costs assigned to power such as greenhouse gas offsets and water for power fees.

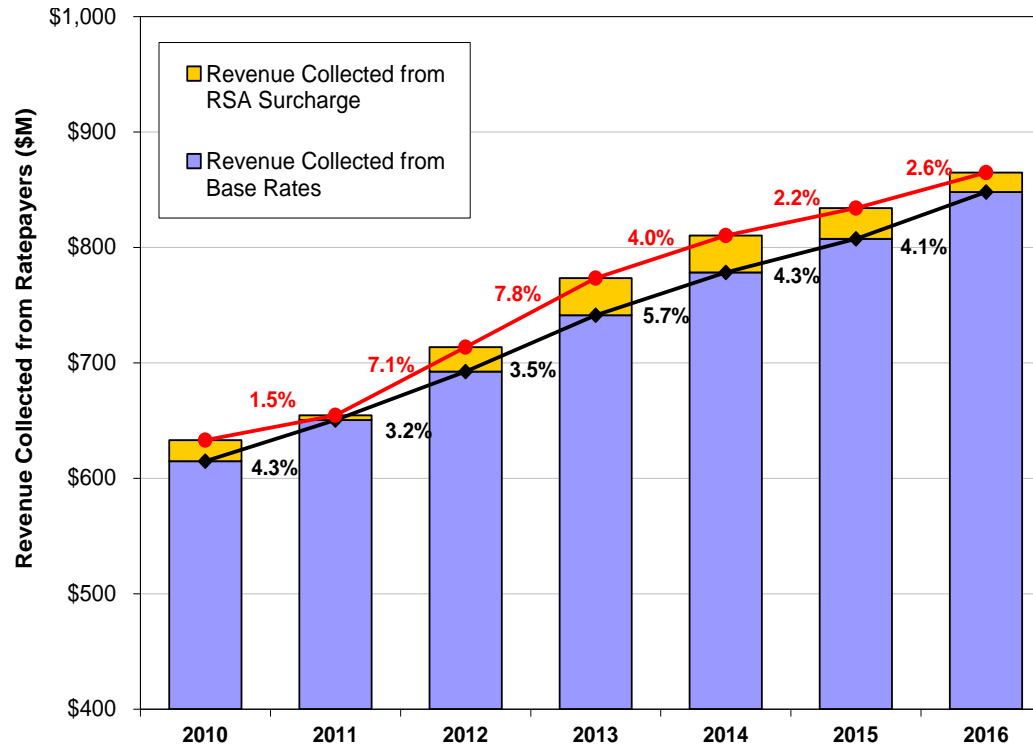
## 4. Financial Baseline Rate Projection (not including RSA surcharges)



# Major cost drivers for rate projection

- **~45% = Debt service**
  - \$180M wholesale revenue shortfall in 2009-2010 caused higher debt financing of capital program
  - Change in financial policy re debt service coverage from 2.0 to 1.8 = less capital financed with operating revenue
  - 2010 bond refinancing benefits taken mostly in 2010-2011
- **~35% = Power costs**
  - BPA rates rising and higher cost of I-937 renewables
  - Wholesale revenues lower (gas prices, less surplus)
- **~20% = O&M costs**
  - Some costs shifted from 2012 to 2011 to reduce rate increase
  - Returns to sustainable level in 2013
  - Some elements expected higher than inflation

# Rate projection with RSA surcharges given RSA ordinance baseline vs SCL forecast



- If rates are set per RSA ordinance baseline, RSA account balance may erode and rate surcharges could be implemented.
- Alternative: set base rates higher, with lower wholesale revenue expectation.

# 4.1 Overall Conclusions

## 1. Controllability of rate increase drivers

- More controllable
  - Program additions (not in baseline)
  - No. of staff/how work is performed
  - Size/timing of future capital budgets
- Less or not controllable
  - Labor cost changes
  - Net wholesale energy prices and volumes
  - Regulatory requirement costs
  - Interest rates on new debt
  - Debt service for capital spending already completed

## 4.1 Overall Conclusions

2. All spending is reflected in rates, but financial policies determine timing, e.g.,

- Debt financing of CIP
  - Spreads capital costs across years
  - Adds interest cost
  - Debt service coverage target affects how much is debt financed
- Net wholesale revenue
  - Higher revenue assumption = lower initial base rate
  - If not realized, higher debt (and higher future rates) or RSA surcharges make up the difference



## 4.1 Overall Conclusions

### 3. Rates

- Increases higher than inflation next several years
- Long-term expectation: closer to rate of inflation
- Increases start from low base, less customer impact
- Lower increase and less volatility than other commodities
- Likely to remain among lowest in nation and region

### 4. Cost drivers

- Subject to trends facing industry
- More insulated from other cost pressures due to clean renewable power supply

### 5. Baseline maintains current level of service

- Opportunities for improvement/cost reductions